IN THE

Supreme Court of the United States

OCTOBER TERM, 1951

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No. 534

UNITED STATES TRUST COMPANY OF NEW YORK, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY FIRST GENERAL MORTGAGE,

Appellant-Petitioner,

vs.

EDGAR F. ZELLE, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY, ET AL.,

Appellees-Respondents.

JOSEPH R. WARNER, SAMUEL S. HALL, JR., and PHILIP N. CRISTAL, AS A PROTECTIVE COMMITTEE FOR THE HOLDERS OF WISCONSIN CENTRAL RAILWAY COMPANY FIRST GENERAL MORTGAGE FIFTY YEAR FOUR PER CENT GOLD BONDS DUE JULY 1, 1949,

Appellants-Petitioners,

vs.

EDGAR F. ZELLE, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY, ET AL.,

Appellees-Respondents.

THE GASTON GROUP OF HOLDERS OF WISCONSIN CENTRAL RAILWAY COMPANY FIRST GENERAL MORTGAGE BONDS,

Appellants-Petitioners,

vs.

EDGAR F. ZELLE, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY, ET AL.,

Appellees-Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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INDEX

	Page
Opinions Below	2
Statement of Basis of Jurisdiction to Review	2
Questions Presented	3
Summary Statement of Matter Involved	3
Reasons Relied on for the Allowance of the Writ	7
1. The decision below of the Court of Appeals for the Eighth Circuit is in direct conflict with a decision of a court of appeals of another circuit on the same question	7
2. The decision below is in conflict with applicable decisions of this Court	9
3. The decision below misinterprets the decision of this Court in *Vanston Committee v. Green,* 329 U. S. 156	11
4. In the alternative, if the decision below is not in conflict with applicable decisions of this Court, it presents an important question of federal law frequently arising in corporate reorganizations which has not been, but should be, settled by this court	12

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TABLE OF AUTHORITIES

Cases

Page

American Iron Company v. Seaboard Air Line Ry. Co., 233 U. S. 261 ..... 14, 15

Ecker v. Western Pacific R. Corp., 318 U. S. 448 10

Equitable Trust Co. of New York v. Western Pacific Ry. Co., 244 Fed. 485 17

Georgia, Florida & Alabama R. Co. v. Bankers Trust Co., 170 F. 2d 733 11

Group of Investors v. Chicago, M., St. P. & P. Ry. Co., 318 U. S. 523 10

Hickin v. Central Hanover Bank & Trust Co., 162 F. 2d 660 12

In re American Fuel & Power Co., 151 F. 2d 470 14

In re Central of Georgia Ry. Co., 47 F. Supp. 786 17

In re New York, New Haven & Hartford R. Co., 64 F. Supp. 487 17

In re Technical Marine Maintenance Co., 169 F. 2d 548 .. 8

In re Wisconsin Central Railway Company, 63 F. Supp. 151 ..... 6, 8

In re Wisconsin Central Railway Company, 93 F. Supp. 579 2

Johnson v. Norris, 190 Fed. 459 14

Louisville Bank v. Radford, 295 U. S. 555 11

O'Brien v. Young, 95 N. Y. 428 16

R. F. C. v. Denver & R. G. W. R. Co., 328 U. S. 495 10

Thompson v. Getz, In re Plymold Corporation, 178 F. 2d 325 ..... 7, 8
Ticonic Bank v. Sprague, 303 U. S. 406..... 9, 10, 11, 12
United States Trust Co. of New York v. Zelle, 191 F. 2d 822 2
Vanston Committee v. Green, 329 U. S. 156..... ..... 7, 8, 10, 11, 12, 13, 14, 15, 16

Statutes

Title 28, United States Code, Judiciary and Judicial Procedure, Section 1254 2
Section 77 of the Bankruptcy Act..... 3, 4, 8, 15, 16
Supreme Court Rules, Rule 38 (5)..... 2

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PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners, United States Trust Company of New York, as Trustee of Wisconsin Central Railway Company

First General Mortgage; Joseph R. Warner, Samuel S. Hall, Jr. and Philip N. Cristal, as a Protective Committee for the holders of Wisconsin Central Railway Company First General Mortgage bonds; and The Gaston Group of holders of Wisconsin Central Railway Company First General Mortgage bonds, respectfully pray for a writ of certiorari to the Court of Appeals for the Eighth Circuit to review judgments entered October 18, 1951 (R. 165, 166, 167) affirming a decision of the District Court for the District of Minnesota (R. 126), holding that the First General Mortgage bondholders were not entitled to receive 6% interest but should receive only 4% interest after July 1, 1949, the contract maturity date of the First General Mortgage.

OPINIONS BELOW.

The opinion of the Court of Appeals is reported in *United States Trust Co. of New York v. Zelle,* 191 F. 2d 822. The opinion of the District Court is reported in *In re Wisconsin Central Railway Company,* 93 F. Supp. 579.

STATEMENT OF BASIS OF JURISDICTION TO REVIEW.

This Court has jurisdiction under Section 1254 of the Judicial Code, 28 U. S. C. A. §1254, and under Section 5 of General Rule 38 of this Court, to review the decision of the Court of Appeals for the Eighth Circuit.

QUESTIONS PRESENTED.

The questions presented to this Court are:

1. Whether, in a railroad reorganization under Section 77 of the Bankruptcy Act or in other proceedings under that Act, interest fully earned on a fully secured claim, where the contract is silent as to the rate applicable after maturity, is to be allowed for the period after maturity at the legal rate under the applicable state law, or whether, because of the bankruptcy proceedings, the Court need not allow the applicable statutory rate of interest.

2. Whether, in the circumstances recited above and where the First General Mortgage bonds could have been paid off or refunded at their maturity date but for the Court's order enjoining payment, interest should be allowed after maturity at the applicable statutory rate as an administrative expense of operating the debtor's property in the interests of the junior claimants, the debtor and its stockholders, and the public.

SUMMARY STATEMENT OF MATTER INVOLVED.

The three petitioners in the pending proceedings for reorganization under Section 77 of the Bankruptcy Act in the United States District Court for the District of Minnesota entitled "In the Matter of Wisconsin Central Railway Company, Debtor," all asked the District Court for a determination that the First General Mortgage bondholders were entitled to 6% interest, the legal rate applicable under the law of New York where no contract rate is specified, after July

1, 1949, the maturity date of their mortgage, which had provided for 4% up to maturity but which, as well as the bonds themselves, was without definite provision as to the interest rate after maturity. The petitioners were held entitled by the District Court to only 4% interest and all three petitioners appealed to the Court of Appeals for the Eighth Circuit. All three appeals were presented and heard together on a single printed record (R. 156) and judgments were entered by the Court of Appeals affirming the judgment below (R. 165, 166, 167). It is to review these judgments of affirmance that certiorari is asked.

The sole question presented to this Court is what rate of interest should be allowed on the First General Mortgage bonds of the debtor after their maturity on July 1, 1949. In 1899 the debtor issued its First General Mortgage bonds due July 1, 1949. These bonds bore 4% interest until their due date but contained no definite provision as to the rate of interest thereafter.

On December 2, 1932, the United States District Court for the District of Minnesota, upon a creditor's petition, entered an order in the usual form, appointing a receiver for the Wisconsin Central Railway Company (R. 8). "The order * * *," as stated by the Court of Appeals, "contained the usual and typical provision enjoining the payment of Wisconsin Central's debts or the interference with its operation." (R. 159). On September 30, 1944, an order of the District Court was entered approving a petition for reorganization under Section 77 of the Bankruptcy Act (R. 11). "Again the usual and customary order was made in the reorganization proceedings, prohibiting the payment of debts of the debtor without the approval of the court and placing the

entire operation of the debtor company under the control and direction of the court." (Opinion of Court of Appeals, R. 160). By order entered March 17, 1945, E. A. Whitman and Edgar F. Zelle were appointed trustees (R. 20), and on the death of E. A. Whitman, Edgar F. Zelle was by order dated August 12, 1947, continued as sole trustee (R. 28).

At the present time there are $12,455,000 principal amount of the debtor's First General Mortgage bonds outstanding. "The First Mortgage bonds being amply secured, interest was paid during the period of bankruptcy (although not always at regular intervals) at the rate of 4 per cent up to July 1, 1949, the date of maturity of the bonds." (Opinion of Court of Appeals, R. 160).

In respect to the interest accruing on the bonds after July 1, 1949, their covenanted date of maturity, your petitioner, United States Trust Company of New York, as Trustee under the First General Mortgage, on May 5, 1949, petitioned the District Court for an order directing and determining that the bondholders under such mortgage were entitled to interest on the principal of their bonds at the rate of 6% per annum from July 1, 1949, the maturity date named in such mortgage, and that the court direct the debtor's trustee to accrue on his records interest on the First General Mortgage bonds at the rate of 6% per annum commencing July 1, 1949 (R. 38, 40-41). The answer of the Gaston Group of First General Mortgage bondholders to such petition joined in the prayer of the petition (R. 45-46) and on November 25, 1949, a petition was filed by the Protective Committee for holders of the First General Mortgage bonds asking that interest for the six months' period after July 1, 1949, be paid at 6% (R. 50).

Thereafter an order was entered December 22, 1949, directing that the petition of the Protective Committee be consolidated for hearing with the petition of the First General Mortgage Trustee (R. 67).

Answers to petitioners' applications to the District Court were interposed by the debtor's trustee (R. 48, 64) and other parties to the reorganization proceedings, who contended that the applicable rate of interest after maturity of the bonds should be 4%, the rate that had been in effect prior to that time. Petitioners on the other hand contended that on the expiration of the covenanted 4% period, there being nothing in the mortgage fixing the interest rate beyond that time, the applicable rate thereafter should be 6%, the rate declared by New York law to be the one applicable where no rate was specifically contracted for after maturity.

It was stipulated that the net income of the road had been and is currently being impounded for the benefit of the several mortgages, including the First General Mortgage (R. 75), which has the undisputed first lien, and is sufficient to pay interest on the First General Mortgage bonds at 6% (R. 75). It is agreed (R. 75), and was so found by the District Court (R. 128) and the Court of Appeals (R. 160), that the mortgage is fully secured.

The District Court, which had on a previous similar application (reported in 63 F. Supp. 151) in respect to another mortgage of the debtor held that the New York 6% rate was applicable after maturity of the principal, held that so far as the provisions of the mortgage itself were concerned the New York statutory rate of 6% would apply, but concluded that, in view of what it characterized as the "teachings" of the opinion of this Court in the intervening case

of *Vanston Committee v. Green,* 329 U. S. 156, it should now find that there were "equities to be given effect by a bankruptcy court" and that these equities called for allowing interest after maturity at the same 4% rate as prevailed before maturity. The District Court therefore adjudged the applicable rate after maturity to be 4% and not 6%, as contended by petitioners.

This decision was affirmed on the same grounds by the Court of Appeals for the Eighth Circuit. It is to review the latter decision that your petitioners ask a writ of certiorari.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The decision below of the Court of Appeals for the Eighth Circuit is in direct conflict with a decision of a court of appeals of another circuit on the same question.

The decision below is in conflict with the decision of the Court of appeals for the First Circuit in *Thompson v. Getz, In re Plymold Corporation,* 178 F. 2d 325. In the latter case, as in the present case, both being bankruptcy proceedings, there was no definite provision in the notes or in the mortgage securing the same specifying the interest rate after maturity of the principal. In the case in the First Circuit the court allowed interest at the statutory rate under the law of Massachusetts, the applicable jurisdiction; a holding directly contrary to that made in the present case. Between the two decisions there is irreconcilable conflict. Both *Thompson v. Getz, supra,* decided December 8, 1949, and the

decision below (handed down October 18, 1951) were decided subsequent to the decision of this Court in *Vanston Committee v. Green*, 329 U. S. 156 (handed down December 9, 1946), dealing with the entirely different claim of interest upon overdue interest, the "teachings" of which the Court of Appeals for the Eighth Circuit, as well as the District Court, felt impelled a decision contrary to that of the First Circuit in *Thompson v. Getz, supra*, and also directly contrary to the earlier allowance of a claim for interest at the statutory rate after maturity on another similar mortgage in these very proceedings, *In re Wisconsin Central Railway Company*, 63 F. Supp. 151, 159.

Although somewhat different on the facts, the decision in the instant case is clearly contrary to the decision of the Third Circuit in *In re Technical Marine Maintenance Co.*, 169 F. 2d 548 (C. A. 3rd, 1948).

The decision below has manifestly precipitated a conflict among the circuits, so that there is sharp divergence of view as to what rate of interest should be applied in bankruptcy after the maturity of a mortgage where the mortgage itself is silent on the subject. Such conflict of authority presents an instance of those conflicts in which the prerogative of the court of last resort may and properly should be invoked to settle the question now unresolved.

The question is an important one, arising wherever in a bankruptcy proceeding there may be a maturing fully secured obligation whereof immediate funding may not be practicable, and the conflict should be settled by the decision of this Court. Such situations arise not only in reorganizations under Section 77 but can and often do arise in any bankruptcy proceeding or equity receivership. (See *Thompson v. Getz, supra*).

2. The decision below is in conflict with applicable decisions of this Court.

A.

This Court has uniformly held that in bankruptcy and other insolvency proceedings where a claim is fully secured as to principal and interest, the legal rate of interest fixed by applicable state law is allowable even after bankruptcy where no rate is specified. *Ticonic Bank v. Sprague,* 303 U. S. 406. That case and its subsequent repeated citation and approval make clear that so long as it is a question merely of fully secured simple interest on the principal balance due, variation in its quantum as it accrues will not defeat its allowance.

In *Ticonic Bank vs. Sprague, supra,* this Court said, after referring to the rule that unsecured creditors' claims for interest are cut off at the date of insolvency or bankruptcy (p. 412):

> "The liability in personam of the bank gives rise to a claim in rem against the free assets in the hands of the receiver; the claim in rem against the security continues as a claim in rem against that same security. With respect to the former the secured creditors have merely the same rights as any general creditor, and insofar as dividends are paid to secured creditors from free assets, they share ratably with the unsecured creditors, and their claims bear interest to the same date, that of insolvency. Compare *Merrill v. National Bank of Jacksonville,* 173 U. S. at 146; *Aldrich v. Chemical National Bank,* 176 U. S. 618, 638. But to the extent that one debt is secured and another is not there is manifestly an inequality of rights between the secured and unsecured creditors, which can-

not be affected by the principle of equality of distribution (*American Iron & Steel Mfg. Co. v. Seaboard Airline Ry.*, 233 U. S. at 266; *Chemical Bank v. Armstrong*, 59 Fed. at 376-377), and interest accruing after insolvency may not be withheld on account of that principle.

"The rule as to the date to which interest is to be allowed, on secured claims sharing *pro rata* with unsecured claims, cannot apply to the disposition of pledged or mortgaged assets subject to the lien of individual creditors, unless we are to disregard the rights in these assets prior to insolvency. But 'liens, equities or rights arising *** prior to insolvency and not in contemplation thereof, are not invalidated.' *Scott v. Armstrong*, 146 U. S. 499, 510; *Merrill v. National Bank of Jacksonville*, 173 U. S. 131, 145."

This case has been cited and approved by this Court in many recent opinions, including railroad reorganization cases and the *Vanston* case itself. See *Ecker v. Western Pacific R. Corp.*, 318 U. S. 448, 510; *Group of Investors v. Chicago, M., St. P. & P. Ry. Co.*, 318 U. S. 523, 573; *R. F. C. v. Denver & R. G. W. R. Co.*, 328 U. S. 495, 521; *Vanston Committee v. Green*, 329 U. S. 156, 164, 165.

The rule that fully secured simple interest must continue to be allowed to date of payment in a bankruptcy is fully established and has in fact been recognized in the *Vanston* and other recent cases, and it is established by the *Ticonic Bank* case and others following it that the quantum of such interest is (1) the contract rate so long as the contract declares the rate, and (2) the legal rate where the contract is silent—in this case 4% to July 1, 1949, and 6% thereafter.

B.

The Court of Appeals erred in holding that the lien of a fully secured mortgage for interest accruing after the maturity of the principal may be destroyed or its amount diminished by the bankruptcy of the debtor. Such a holding is contrary to law and if followed would result in the unlawful destruction, in bankruptcy proceedings, of fully secured liens. This holding is in conflict with repeated decisions of this Court. Among them is the decision in the leading case of *Louisville Bank v. Radford,* 295 U. S. 555, in which this Court held that the taking away of substantial rights in property consisting of a lien, acquired by the secured creditor prior to the passage of the act authorizing the procedure, was in violation of the Fifth Amendment of the Federal Constitution, and categorically declared that the bankruptcy power was subject to the Fifth Amendment.

3. The decision below misinterprets the decision of this Court in *Vanston Committee v. Green,* 329 U. S. 156.

The court below regarded the *Vanston* case as laying down new rules in spite of the reaffirmation of *Ticonic Bank v. Sprague,* 303 U. S. 406, and many other bankruptcy and insolvency cases in the Court's opinion in the *Vanston* case.

Other courts of appeal have not so regarded *Vanston.*

Thus in *Georgia, Florida & Alabama R. Co. v. Bankers Trust Co.,* 170 F. 2d 733, the Court of Appeals for the Fifth Circuit in discussing the *Vanston* case said (p. 734) that that decision, "here relied on, does not in our opinion propound any new law in respect of interest accruing during receiverships and bankruptcies."

And in *Hickin v. Central Hanover Bank & Trust Co.*, 162 F. 2d 660, the Court of Appeals for the Second Circuit applied in bankruptcy an increased rate of interest after the expiration of a contracted period calling for a lower rate, and did so although as in the case at bar there was the usual court order preventing prompt payment of the interest, thus bringing the higher rate into effect. The Court there says, (p. 663) "We find nothing in *Vanston Bondholders Protective Committee v. Green* 327 U. S. 156, 67 S. Ct. 237 to the contrary."

Both courts below mistakenly applied *Vanston*. That decision is not applicable here. It decided that a claim based upon a covenant to pay interest on interest in default was of a penal nature and not allowable in bankruptcy. It had nothing to do with determining what rate of interest should be paid after maturity on a bond that was fully secured both as to principle and interest at the statutory rate.

4. In the alternative, if the decision below is not in conflict with applicable decisions of this Court, it presents an important question of federal law frequently arising in corporate reorganization which has not been, but should be, settled by this Court.

If cases like *Ticonic Bank v. Sprague, supra,* have not determined the rate of interest allowable on a fully secured claim in a federal bankruptcy or other insolvency proceeding where, as here, the contract does specify a rate of interest up to maturity but none thereafter, then the question, certainly an important one under federal bankruptcy law, should be settled by this Court.

A.

Neither of the courts below cited any decision either from this Court or from any other court holding that equitable principles justified a federal bankruptcy court in disallowing fully secured statutory legal interest after maturity where such rate happened to be higher than the contract rate specified up to but not after maturity. The sole asserted authority for the decision below was *Vanston Committee v. Green*, 329 U. S. 156. But in the *Vanston* case what was disallowed was something altogether different from what is being disallowed here. There a claim for interest on interest, penal in its nature and not even allowable by the law of the applicable jurisdiction, was stricken down. In extending this principle to the case of a claim for fully secured simple interest, or to whatever portion of it may represent an increase over what had been the rate prior to maturity, the court below unwarrantably enlarged the scope of the *Vanston* decision.

The fundamental difference between a claim for interest on interest, presented in the *Vanston* case, and one for simple interest after maturity, as in the case at bar, is revealed in considering that the former always and of necessity means a new burden imposed on the debtor. It always adds to the load of debt; it never lightens it. But when the period has run out for which a covenanted rate of interest had been provided in the contract and is succeeded by a new period for which the contract has not defined the rate of interest, then the application of the prevailing legal rate may increase the load of debt or may lighten it. The legal rate may be higher or may be lower than the contractual rate. In fact the *Vanston* case itself, as appears from the opinion of the Court of

Appeals for the Sixth Circuit in 151 F. 2d 470, 473, 475 (*sub nom. In re American Fuel & Power Co.*), involved 6½% and 7% bonds.

If unsecured creditors should ultimately have their claims satisfied in full in these proceedings, they will presumably be allowed 6% interest from the date of the insolvency up to the effective date of a plan of reorganization. *American Iron Co. v. Seaboard Air Line Ry.*, 233 U. S. 263, 267; *Johnson v. Norris*, 190 Fed. 459. Thus if the decision below were to stand, cases may, and undoubtedly in due course will, arise, where the bankruptcy court will be allowing unsecured creditors higher interest than fully secured creditors for periods where both claims would, under applicable state law, be entitled to the same statutory legal interest—a startling result for an application of equitable principles.

Again there is nothing in the opinion of the Court of Appeals to suggest that if the mortgage itself had contained a provision, valid under state law, for 6% interest after maturity, such interest would not have been allowed.

One ground for its decision recited by the court below was that payment of the principal of the bonds had been prohibited by order of the court; that "it was the intervention of bankruptcy and the assumption of the directing authority of the court that was the cause of the non-payment of the bonds." For this the court below finds support in the opinion in the *Vanston* case. But it must be borne in mind that the *Vanston* case had to do with the relatively minor feature of interest on interest, which presumably the debtor would have paid had it not been enjoined. In the present case there was some $20,000,000 of principal due when the proceeding began. What the court enjoined was enforced collection by

the creditor without permission of the court. It was the creditor that was stayed, and it is well established that a temporary restraining order does not prevent the accrual of simple interest on claims fully secured by property from which the debtor's estate is receiving the income.

In *American Iron Company v. Seaboard Air Line Ry.* (233 U. S. 261) this Court stated the principle most emphatically (p. 266):

> "The Railway Company insists that, whether treated as part of the debt or allowed as damages, interest can only be charged against the Railway because of delay due to its own fault, while here the failure to pay was due to the act of the law in taking its property into custody and operating the same by Receivers in order to prevent the disruption of a great public utility."

But as the Court points out (ib.):

> "As this delay was the act of the law, no one should thereby gain an advantage or suffer a loss."

And concludes (p. 267):

> "Manifestly, the law does not contemplate that either the debtor or the trustees can, by securing the appointment of Receiver, stop the running of interest on claims of the highest dignity."

If the *Vanston* opinion is read as departing from this established principle, especially when its comment on this aspect of the case was on a point not briefed or argued, then we submit that in this respect that decision should be clarified.

The unreasonableness of the decision below is further demonstrated by considering it in connection with Section 77(g) of the Bankruptcy Act which permits the dismissal of the

proceeding for undue delay. If relief under this section of the Bankruptcy Act is given, there would seem to be no question but that the claim of petitioners for 6% interest would have to be granted. *O'Brien v. Young,* 95 N. Y. 428, at 433 (1884), aff'd. 146 U. S. 162 (1892).

From every aspect it is manifest that the decision below so broadens the scope of *Vanston,* which had merely to do with a quasi-penal claim for interest on interest, that the *Vanston* opinion should be reexamined, not with a view of overruling it but to define with precision the scope of its teaching.

B.

Question number 2 raises a point of major importance in federal law which, if it has not been, should be authoritatively determined. This question is based on the premise that in a reorganization proceeding such as one under Section 77 of the Bankruptcy Act, interest after maturity which has been fully earned on a fully secured obligation should be allowed at the applicable statutory rate as an expense of administration where, as the courts below here held (R. 131, 163-164), the obligation could have been paid off or refunded at maturity.

Under these circumstances and in the absence of any agreement to the contrary in the bonds or the mortgage, equity would seem to require allowance of the statutory rate, here 6%, so long as payment is withheld, just as the courts have done on various other claims in reorganizations and receiverships.

In *In re Central of Georgia Ry. Co.*, 47 F. Supp. 786, interest at the legal rate was allowed on certain rent payments, the court there saying (p. 794):

"Insolvency ought not to give the lessee's creditors greater rights to possession than the lessee himself enjoyed. The equities require interest also because the operations of the leased line have been quite profitable and the lessee's creditors get the benefits arising. Interest should be allowed."

Again in *In re New York, New Haven & Hartford R. Co.*, 64 F. Supp. 487, the court allowed 6% interest as damages for withholding realization on certain collateral, saying (p. 495):

"Interest as Damages. The appellate opinion contemplates that the damage done the banks shall be made good to them. Obviously the payment *now* of what they could have realized *then* does not compensate them for the loss of the interim use of the monies they were entitled to realize. I hold that interest at 6% from the date of the injunction to the date of the entry of the order hereon is recoverable. The order to be entered hereon shall provide for payment of such interest in addition to the realizable value of the pledged stocks."

See also *Equitable Trust Co. of New York v. Western Pacific Ry. Co.*, 244 Fed. 485, (C. C. A. 2nd; cert. denied 246 U. S. 672), where the court said (p. 508):

"It is possible that questions will arise for determination before a decree can be determined. I can at present think of none, except the rate of interest which will accrue upon the unpaid balance of the three installments and upon the balance of the principal. In New York the rate of interest upon default is fixed at the legal rate regardless of the rate before maturity, Pryor v. City of Buffalo, 197 N.

Y. 123, 90 N. E. 423, and the matter is one of state law, Ohio v. Frank, 103 U. S. 697, 26 L. Ed. 531. It seems to result, therefore, that the interest must be calculated at 6 per cent., which rate with reluctance I feel obliged to fix."

Allowance of interest as an administrative expense at the statutory rate applicable after maturity—where as here no rate was specified and the debt could have been satisfied or refunded at maturity—would thus seem to be in accordance with the actual practice of the federal district courts in analogous situations.

The frequency wherein under varying circumstances a receivership or bankruptcy reorganization court is required to determine the rate of interest applicable calls for an answer from this Court as to the principles which should govern the allowance of interest as an administrative expense where delivery of property or payment of a claim is unnecessarily or wrongfully withheld from the persons entitled, and where the withholding has inured to the benefit of junior claimants, or of the bankrupt itself or its stockholders.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari may be issued out of and under the seal of this Court, directed to the United States Court of Appeals for the Eighth Circuit, commanding that court to certify and send this Court, on a day certain to be therein named, a full and complete transcript of the record and of all proceedings in the cases numbered and entitled on its docket, "No. 14,307, United States Trust Company of New York, as Trustee of Wisconsin Central Railway Company First General Mortgage, Appellant, vs. Edgar F. Zelle, as Trustee of Wisconsin Central Railway Company, et al., Appellees; No. 14,308,

Joseph R. Warner, Samuel S. Hall, Jr., and Philip N. Cristal, as a Protective Committee for the holders of Wisconsin Central Railway Company First General Mortgage Fifty Year Four Per Cent Gold Bonds due July 1, 1949, Appellants, vs. Edgar F. Zelle, as Trustee of Wisconsin Central Railway Company, et al., Appellees; No. 14,309, The Gaston Group of holders of Wisconsin Central Railway Company First General Mortgage Bonds, Appellant, vs. Edgar F. Zelle, as Trustee of Wisconsin Central Railway Company, et al., Appellees," to the end that said causes may be reviewed and determined by this Court, that the judgments of said Court of Appeals entered October 18, 1951, be reversed and that your petitioners be granted such other and further relief as to this Honorable Court may seem just and proper.

Dated: January 11, 1952.

Respectfully submitted,

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1951.

No. 534.

UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of Wisconsin Central Railway Company First General Mortgage.
Appellant-Petitioner,

vs.

EDGAR F. ZELLE, as Trustee of Wisconsin Central Railway Company, *et al.*,
Appellees-Respondents.

JOSEPH R. WARNER, SAMUEL S. HALL, JR., and PHILIP N. CRISTAL, as a Protective Committee for the Holders of Wisconsin Central Railway Company First General Mortgage Fifty Year Four Percent Gold Bonds Due July 1, 1949,
Appellants-Petitioners,

vs.

EDGAR F. ZELLE, as Trustee of Wisconsin Central Railway Company, *et al.*,
Appellees-Respondents.

THE GASTON GROUP OF HOLDERS OF WISCONSIN CENTRAL RAILWAY COMPANY FIRST GENERAL MORTGAGE BONDS.
Appellants-Petitioners,

vs.

EDGAR F. ZELLE, as Trustee of Wisconsin Central Railway Company, *et al.*,
Appellees-Respondents.

BRIEF OF RESPONDENT WISCONSIN CENTRAL RAILWAY COMPANY, DEBTOR, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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February 15, 1952.

THE COURT PRESS, 130 Cedar Street, N. Y. C.

INDEX.

PAGE

Opinions Below 1

Jurisdiction 2

Questions Presented 2

Statement 2

Argument 4

1. The decisions of this Court in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, rehearing denied 329 U. S. 833, and *Fleming, et al.* v. *Traphagen, et al.*, 329 U. S. 686, are dispositive of the issues presented on this appeal 4

2. There is no conflict among the Circuits on the same question, and there is likewise no conflict with applicable decisions of this Court 6

3. No important questions of Federal law are presented that have not already been settled by this Court 9

Conclusion 10

CITATIONS:

Cases:

American Fuel & Power Co., In re, 151 F. 2d 470, aff'd on other grounds 329 U. S. 156 4

Erie R. R. v. *Tompkins*, 304 U. S. 64 4

Fleming, et al. v. *Traphagen, et al.*, 329 U. S. 686 . . ..4, 5, 6

Louisville Bank v. *Radford*, 295 U. S. 555 ..... 7, 8

PAGE

Manufacturers Trust Co. v. *Realty Associates Sec. Corp.*, 332 U. S. 836 8

Realty Associates Securities Corporation, In re, 163 F. 2d 387 ..... 8, 9

Technical Marine Maintenance Co., In re, 169 F. 2d 548 7

Thompson v. *Getz* (*In re Plymold Corporation*), 178 F. 2d 325 ..... 6, 7

Ticonic National Bank v. *Sprague*, 303 U. S. 406. 7

United States Trust Co. of New York v. *Zelle*, 191 F. 2d 822 1

Vanston Bondholders Protective Committee v. *Green*, 329 U. S. 156, rehearing denied 329 U. S. 833 . . ..4, 5, 6, 9

Wisconsin Cent. Ry. Co., Re, 93 F. Supp. 579 ... 1

Statutes:

Bankruptcy Act:
Chapter XI 6
Section 77 .....2, 10

Title 28 U. S. C. A. §1254 2

Miscellaneous:

Supreme Court Rules, Rule 38(5) 2

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Appellants-Petitioners,

vs.

EDGAR F. ZELLE, as Trustee of Wisconsin Central Railway Company, *et al.*,

Appellees-Respondents.

BRIEF OF RESPONDENT WISCONSIN CENTRAL RAILWAY COMPANY, DEBTOR, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Opinions Below.

The opinion of the Court of Appeals is reported in 191 F. 2d 822. The opinion of the District Court is reported in 93 F. Supp. 579.

Jurisdiction.

The petitioners seek the discretionary favor of this Court under Title 28 U. S. C. A. §1254 and Rule 38(5) of the Rules of this Court.

Questions Presented.

1. Where a mortgage matures during reorganization proceedings under Section 77 of the Bankruptcy Act and there is no specific provision in said mortgage as to the rate of interest payable after maturity, is the rate of interest payable between said maturity date and the effective date of a plan of reorganization to be determined by state law or principles of equitable distribution under corporate reorganization law?

2. Was the decision below that principles of equitable distribution under corporate reorganization law justified a charge of interest at the rate of 4% per annum after maturity, the same rate that had been paid for over half a century prior to maturity, an improvident ruling?

Statement.

Wisconsin Central Railway Company, the debtor, a Wisconsin corporation, filed a petition for reorganization under Section 77 of the Bankruptcy Act on September 30, 1944 in the District Court of the United States for the District of Minnesota, Fourth Division. The usual order was entered freezing the enforcement of claims. Reorganization proceedings are still pending.

The First General Mortgage (first mortgage on debtor's main line) has $12,455,000 (principal amount) outstanding. Said mortgage matured July 1, 1949. Interest at the rate of 4% per annum is being paid on regular interest dates and there are no interest arrearages thereon.

The rate of interest payable on said mortgage until maturity is specified in the mortgage at 4% per annum. The indenture is silent on the rate of interest payable after maturity.

It is undisputed that new securities to be allocated to the first mortgage bondholders under a plan of reorganization finally confirmed will carry interest (or a dividend return) as prescribed in the plan. Hence the pending application concerns the narrow issue as to the rate of interest chargeable between July 1, 1949, the maturity date of the mortgage, and the effective date of a plan.

Petitioners argue that the appropriate rate of interest chargeable during the hiatus aforesaid, should be equal to the statutory rate payable in New York, to wit, 6% per annum, inasmuch as the mortgage was made and is payable in New York. The respondents urge, as the Court of Appeals and District Court found, that the true test is the application of equitable principles of distribution under reorganization law; that under said test, a rate of 4% per annum during the hiatus, the same rate that has been paid ever since the mortgage was made over half a century ago, is a fair rate.

The issue boils down to the question whether a finding that 4% per annum is a fair rate, constitutes an abuse of discretion.

ARGUMENT.

1. The decisions of this Court in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, rehearing denied 329 U. S. 833, and *Fleming, et al.* v. *Traphagen, et al.*, 329 U. S. 686, are dispositive of the issues presented on this appeal.

Vanston Bondholders Protective Committee v. *Green*, 329 U. S. 156, decided by this Court December 9, 1946, presented an exploration by this Court into interest issues in corporate reorganizations under the Bankruptcy Act. The precise issue related to a claim of interest upon interest, but in probing and resolving said issue, this Court clarified and reaffirmed principles of law applicable to interest claims generally.

In the *Vanston* case, the District Court had applied the conflict of laws rule and held that interest upon interest was allowable under New York law. Agreeing with the District Court's holding that the principles of *Erie R. R.* v. *Tompkins* (304 U. S. 64) applied, the Court of Appeals differed, however, on the construction of New York law, ruling that the New York law forbade a charge of interest upon interest. *Sub nom. In re American Fuel & Power Co.*, 151 F. 2d 470. This Court granted certiorari (327 U. S. 774) and affirmed the mandate of the Court of Appeals—but on different grounds.

Flatly repudiating the suggestion that the conflict of laws rule applied, this Court held that the allowance of the claim was subject to a different test, to

wit, compatibility with the policy of the Bankruptcy Act, thus (at p. 163):

> "But bankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by the Court in accordance with authority granted by Congress to determine how and what claims should be allowed under equitable principles. * * * When and how and under what circumstances Federal courts will allow interest on claims against debtor's estates being administered by them has long been decided by federal law."

And at page 165:

> "It is manifest that the touchstone of each decision in allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor."

There are a full complement of adverse interests at bar, to wit, secured senior creditors against secured and unsecured junior creditors and stockholders and secured and unsecured junior creditors against stockholders.

In unmistakable terms, the *Vanston* case thus set the pattern for the decision below, and left little room for doubt. A return of 4% per annum, the rate paid for half a century, was the logical and fair rate to continue for the limited period between maturity of the mortgage and the effective date of a plan.

Upon the heels of the *Vanston* case came the decision of this Court in *Fleming, et al.* v. *Traphagen, et al.*, 329 U. S. 686, which involved a claim of interest upon interest in the *Rock Island Reorganization.*

The bonds in the *Fleming* case were not affected by a plan of reorganization. Stressing this distinction, the Court of Appeals (7th Cir.) held that state law (Pennsylvania) should govern, and allowed interest upon interest. This Court reversed on the authority of the *Vanston* case.

In face of the fact that the bonds in the *Fleming* case were not even affected by a plan of reorganization, the reversal on the authority of the *Vanston* case is highly significant and establishes beyond cavil that the Court below correctly applied the law and properly exercised its discretion.

2. There is no conflict among the Circuits on the same question, and there is likewise no conflict with applicable decisions of this Court.

A.

The petitioners rely heavily on *Thompson* v. *Getz* (*In re Plymold Corporation*), 178 F. 2d 325, to establish that there is a conflict between the First and Eighth Circuits. The *Thompson* case was not even a corporate reorganization proceeding but an Arrangement proceeding under Chapter XI of the Bankruptcy Act, the successor to the former composition settlement.

Apart from the distinctions that may be drawn between an Arrangement proceeding and a corporate reorganization, the fact that the Court applied the conflict of laws rule in the *Thompson* case of itself

disposes of the petitioners' contentions as to its pertinency. The Court there said (at p. 326):

> "It was agreed by the parties that the notes were executed in Massachusetts, are payable in Massachusetts, and that the Massachusetts law was the governing law in the determination of the issue."

A different type of proceeding was involved in the *Thompson* case. Principles of equitable distribution in corporate reorganizations were not even discussed in the briefs in said case.

In re Technical Marine Maintenance Co., 169 F. 2d 548, the other decision relied on by the petitioners as purporting to establish a conflict on the same question presented on this appeal, has no remote connection therewith.

B.

The contention by petitioners that the determination below conflicts with the decisions of this Court in *Ticonic Bank* v. *Sprague*, 303 U. S. 406 and *Louisville Bank* v. *Radford*, 295 U. S. 555, cannot stand analysis.

The *Ticonic* case involved a voluntary *liquidation* of an insolvent national bank. Naturally, no principles of equitable distribution under corporate reorganizations were involved. The case stands generally for the principle followed in straight bankruptcies that secured creditors are entitled to interest to the date of payment. The case did not involve and the decision did not touch upon the *quantum* of interest chargeable in a corporate reorganization under the facts at bar.

The petitioners seek to bring the facts at bar within the orbit of *Louisville Bank* v. *Radford*, 295 U. S. 555, by characterizing the decision below as a "destruction" of rights of secured creditors, upon the assumption that the first mortgage bondholders had a vested right to 6% (a right they never had!) and hence their claim was allegedly reduced from 6% to 4%. The *Louisville Bank* case has no connection whatever with the true nature of the controversy, to wit, an application to *increase* an interest rate upon equitable grounds.

It is not without significance that the petitioners have also overlooked the burden that rests on all claimants to establish the validity and allowability of all claims.

Apt, we believe, is the following observation of the Court of Appeals in *In re Realty Associates Securities Corporation*, 163 F. 2d 387, 390 (cert. den. *Manufacturers Trust Co.* v. *Realty Associates Sec. Corp.*, 332 U. S. 836):

> "We are not convinced that the 'judgment theory' is applicable in a Chapter X reorganization * * *. It is, of course, necessary to liquidate the debts, but the proposal is not that they will be paid at maturity but that they will be extended in whole or in part by means of substituted obligations * * *. Until a 'plan' is proposed and accepted, * * * the debts do not become due except to that extent and in the manner that the 'plan' provides. That the practice has been to treat the contract rate of interest as continuing to the effective date of the plan in Chapter X and railroad reorganizations is amply shown

by the cases cited by the debtor, although the point does not appear to have been discussed (citing cases)."

3. No important questions of Federal law are presented that have not already been settled by this Court.

The *Vanston* case needs no defining with "precision." Its meaning and compass are crystal clear.

The first mortgage bondholders at bar occupy an enviable position, unique in railroad reorganizations, for they hold bonds serviced on a current basis, with no interest arrears. Their strained arguments about the alleged inequity of the decision below have a hollow ring. Having first priority, it must be assumed that their allocations under a plan will satisfy their senior position and that the quality of their allocation will be superior to that granted junior interests.

It is also not without significance that instead of directing interest payments on the first mortgage prior to consummation, it was within the competence of the District Court to refuse said favor and to bar any interim payments at all on account of interest, relegating said bondholders to their rights under a plan of reorganization. Moreover, it has not been uncommon for the courts to permit interim interest payments and to reduce participation in a plan to the extent of said interim payments.

Since no railroad reorganization has ever been dismissed for undue delay, the arguments of the peti-

tioners as to the significance of such an event are without substance. In any event, it would be closer to reality to be mindful of the provisions of Section 77 of the Bankruptcy Act permitting the alteration of securities, including the power to extend the maturity date of the first mortgage at bar at the same interest date paid for over half a century.

We have confined our discussion to the broad principles involved, stemming from the settled law that a reorganization court is a court of equity and that it may, if not must, apply equitable principles in resolving issues such as are involved at bar. Parenthetically, the decision of the Court of Appeals also points to other possible flaws in the claim for an increased rate of interest; for example, its feeling that there was actually an implied contract to continue the same interest rate after maturity as was paid for over half a century prior to maturity.

CONCLUSION.

Since there has been no showing that the decision below was an improvident exercise of discretion, the petition for a writ of certiorari should be denied.

Dated, February 15, 1952.

Respectfully submitted,

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vs.

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Appellees-Respondents.

THE GASTON GROUP, ETC.,
Appellants-Petitioners,

vs.

EDGAR F. ZELLE, AS, TRUSTEE, ET AL.,
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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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INDEX

	Page
Opinion below	2
Statement of basis of jurisdiction to review	3
Questions presented	3
Summary statement of the matter involved	4
Argument	5
I. Petitioners fail to show any conflict with any other court of appeal	5
II. The decision below is not only not in conflict with any decision of this court, but could not have been decided otherwise in view of the reasoning of this court in *Vanston Bondholders Committee v. Green*, 329 U. S. 156	6
III. The second question posed by the petition raises no issue not covered in connection with the first question	12

TABLE OF AUTHORITIES

CASES: Page

American Iron Company v. Seaboard Air Line Railway, 233 U. S. 261 10
American Surety Co. v. Sampsell, 327 U. S. 269 ... 10
Heiser v. Woodruff, 327 U. S. 726 10
In re Espade Realty Corp., 66 Fed. Supp. 683 11
In re Lorraine Castle Apt. Bldgs. Corp., 158 Fed. (2d) 44 4
In re Technical Marine Maintenance Co., 169 Fed. (2d) 548 5
In re Wisconsin Central Railway Company, 93 Fed. Supp. 579 2
Investors Syndicate v. Baskerville Bros. Holding Co., 200 Minn. 461, 274 N. W. 627 4
Louisville Bank v. Radford, 295 U. S. 555 9
O'Brien v. Young, 95 N. Y. 428 8
Pepper v. Litton, 308 U. S. 295 10
Pruyn v. City of Milwaukee, 18 Wis. 386 4
Spencer v. Maxfield, 16 Wis. 185 4
Thompson v. Getz, 178 Fed. (2d) 325, 16 A. L. R. (2d) 898 ..... 5, 11
Ticonic Bank v. Sprague, 303 U. S. 406 ..... 6, 7
United States Trust Company of New York v. Zelle, 191 Fed. (2d) 822 2
Vanston Bondholders Committee v. Green, 329 U. S. 156 ..... 4, 5, 6, 7, 8, 9, 10, 11, 12, 14

STATUTES AND RULES:

Title 28, U. S. Code, Judiciary and Judicial Procedure, Section 1254 2
Section 77 of the Bankruptcy Act 2
Supreme Court Rules, Rule 38 (5) 2

MISCELLANEOUS:

47 C. J. S. 50 4

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JOSEPH R. WARNER, SAMUEL S. HALL, JR., and PHILIP N. CRISTAL, AS A PROTECTIVE COMMITTEE FOR THE HOLDERS OF WISCONSIN CENTRAL RAILWAY COMPANY FIRST GENERAL MORTGAGE FIFTY YEAR FOUR PER CENT GOLD BONDS DUE JULY 1, 1949,
Appellants-Petitioners,

vs.

EDGAR F. ZELLE, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY, ET AL.,
Appellees-Respondents.

THE GASTON GROUP OF HOLDERS OF WISCONSIN CENTRAL RAILWAY COMPANY FIRST GENERAL MORTGAGE BONDS,
Appellants-Petitioners,

vs.

EDGAR F. ZELLE, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY, ET AL.,
Appellees-Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

This is a joint brief filed on behalf of the following Respondents: Edgar F. Zelle, as Trustee of Wisconsin Central Railway Company, Debtor; Canadian Pacific Railway Company; Empire Trust Company, as Trustee of the First and Refunding Mortgage of Wisconsin Central Railway Company; Minneapolis, St. Paul & Sault Ste. Marie Railroad Company; and First and Refunding Mortgage Bondholders Protective Committee.

OPINIONS BELOW

The opinion of the Court of Appeals is reported in *United States Trust Co. of New York v. Zelle,* 191 Fed. (2d) 822. The opinion of the District Court is reported in *In re Wisconsin Central Railway Company,* 93 Fed. Supp. 579.

STATEMENT OF BASIS OF JURISDICTION TO REVIEW

The petition for certiorari asserts that this Court has jurisdiction to review the decision of the Court of Appeals below under Section 1254 of the Judicial Code (28 U. S. C. A. 1254) and under Section 5 of General Rule 38 of this Court.

QUESTIONS PRESENTED

We believe that the questions as presented by petitioners should be more accurately and specifically rephrased as follows:

In proceedings to reorganize a railroad under Section 77 of the Bankruptcy Act, in which the Court enjoined all payment of principal of and interest on the debtor's bonds except as otherwise ordered so that the estate might be administered and reorganized for the benefit of all creditors in accordance with equitable principles and the provisions of the Act, and in which there matures an issue of senior mortgage bonds which specify interest at the rate of 4% as payable until maturity but do not specify any rate of interest as payable in the event of nonpayment of principal at maturity, is the Court obliged to increase the rate of interest to 6% to conform to the rate specified as damages on defaulted obligations by

the law of the state where the bonds were executed and payable in lieu of continuing to allow interest after maturity at the 4% rate, when the Court holds that it would be inequitable to impose this additional expense on the estate to the financial detriment and disadvantage of the other creditors and that the 4% rate continues to be an appropriate rate under existing economic conditions?

SUMMARY STATEMENT OF MATTER INVOLVED

While we believe that the summary statement included in the petition is adequate for a decision of the question presented to this Court, we point out that petitioners assume that the First General Mortgage Bonds contain no definite provision as to the rate of interest after maturity although the Court of Appeals definitely questioned the correctness of that finding by the trial court. We argued to the trial court that certain provisions of the mortgage sufficiently evidenced an intention that interest should continue to accrue after maturity at the contract rate of 4% per annum. The trial court rejected our argument. In our brief to the Court of Appeals and in oral argument, we urged as an alternative ground for affirmance of the decision of the trial court the same construction of the mortgage which we had urged to the trial court. The Court of Appeals affirmed the trial court on the same ground on which the trial court had decided the case, saying, however, as to our alternative argument:

> "The representatives of the debtor, appellees here, not only contend that the order of the trial court was proper upon equitable principles under the

> Bankruptcy Act, but also insist that the terms of the mortgage and bonds by fair implication call for the payment of interest at 4 per cent after the maturity of the bonds. The trial court held otherwise. While we are definitely inclined to the conclusion that appellees are correct in that contention, we do not deem it necessary to pass upon the question, because of our conclusion that the trial court's order is correct on equitable grounds under the authority of the Vanston case. Nor do we deem it necessary to do more than assume for the purpose of this case that the law of New York would apply, absent overriding provisions of the Bankruptcy Act, for reasons which will be noted" (R. p. 161).

The foregoing quotation shows that the Court below was definitely inclined to reject petitioners' assumption that the mortgage did not contemplate a continuance of the 4% rate after maturity, and also that the Court merely assumed, without deciding, the correctness of petitioners' further assumption that the law of New York is the applicable state law. The Court below did not pass on our contention that, under the principles enunciated in the *Vanston* case, the applicable state law is that of Minnesota, Wisconsin and Illinois, where the debtor's properties are situated and its business conducted, which limit the rate of interest after maturity to the rate which was payable before maturity, namely 4%. *Investors Syndicate v. Baskerville Bros. Holding Co.,* 200 Minn. 461, 274 N. W. 627; *In re Lorraine Castle Apt. Bldgs. Corp.* (C. C. A. 7th, 1946), 158 F. (2d) 44 (citing Illinois cases); *Pruyn v. City of Milwaukee,* 18 Wis. 386; *Spencer v. Maxfield,* 16 Wis. 185; 47 C. J. S. 50.

It is extremely doubtful, therefore, whether the reversal of the Court below on the question presented to this Court would affect the ultimate result of this litigation.

ARGUMENT

I.

Petitioners Fail to Show Any Conflict With Any Other Court of Appeal.

The first decision on which petitioners rely is that of *Thompson v. Getz,* 178 Fed. (2d) 325, 16 A. L. R. (2d) 898, decided by the Court of Appeals for the First Circuit. That case involved the rate of interest after maturity in a reorganization proceeding and, because of the similarity of facts, we concede that the result of that case is contrary to the result of our case; we point out, however, that the question decided by the Court below and which is presented to this Court was not presented to or considered by the Court of Appeals for the First Circuit. That Court considered only questions of state law. The effect of the bankruptcy of the debtor was not mentioned in the opinion or in the summary of argument of counsel as reported at pages 899-900 of Volume 16 of *A. L. R.* (2d). The decision of this Court in *Vanston Bondholders Committee v. Green,* 329 U. S. 156, presenting an entirely different and decisive approach, was not cited in the opinion of the Court of Appeals for the First Circuit or in the briefs to that Court. There is no reason to believe that the Court of Appeals for the First Circuit will feel obligated to, or will follow, its earlier decision if the question should arise in the future.

The other decision of another Court of Appeals relied upon by the petitioners is *In re Technical Marine Maintenance Co.,* 169 Fed. (2d) 548, decided by the Court of Appeals for the Third Circuit. Petitioners concede that the facts of that case are "somewhat different." We find no similarity whatsoever in either the facts, the reason-

ing or the result. That case upheld the validity of a condition in a real estate lease by which the lessor was permitted to terminate the lease in the event of the lessee's bankruptcy despite the contention that termination of the lease prevented any effective reorganization of the debtor as a going concern.

We respectfully submit, therefore, that the writ prayed for in the petition should not be allowed because of any conflict between the decision below and the decision of another Court of Appeals on the same question.

II.

The Decision Below Is Not Only Not in Conflict With Any Decision of This Court, But Could Not Have Been Decided Otherwise in View of the Reasoning of This Court in VANSTON BONDHOLDERS COMMITTEE v. GREEN, 329 U. S. 156.

Petitioners assert that the Court below misinterpreted the decision of this Court in *Vanston Bondholders Committee v. Green,* 329 U. S. 156, and that the decision below is in conflict with several lines of cases decided by this Court, or in the alternative, presents an important question of federal law frequently arising in corporate reorganization which has not been but should be settled by this Court.

Petitioners state first that the decision below is in conflict with *Ticonic Bank v. Sprague,* 303 U. S. 406, and the many cases, including the *Vanston* case, which have cited the *Ticonic Bank* case with approval. The same argument was made below without success. The fundamental fallacy in petitioners' argument was and is that it ignores the very real difference between ordinary simple interest, whether accrued before or after ma-

turity, and interest at an increased rate after maturity. The former was involved in *Ticonic Bank* case; the latter is involved in the present case.

The decision of the Court below is based on the premise that since payment of the First General Mortgage Bonds at maturity had been enjoined by the Bankruptcy Court in order to permit an orderly reorganization of the debtor in accordance with the procedure and principles specified in Section 77 of the Bankruptcy Act, the statutory right under state law to interest at a substantially increased rate after maturity is more akin to the interest on interest which was disallowed in the *Vanston* case than it is to simple interest such as was involved in the *Ticonic Bank* case and in the cases which have followed it. While the *Ticonic Bank* case involved interest at the statutory rate, that rate was allowed because, since the principal sum consisted of misappropriated trust funds, there was no contract rate and the choice was between no interest at all and interest at the statutory rate. With the sole exception of the *Vanston* case, all of the cases cited by petitioners as following the *Ticonic Bank* case involved ordinary simple interest before maturity. The *Vanston* case treats the *Ticonic Bank* case as only one example of the equitable power of the Court in a reorganization proceeding to allow or disallow interest in accordance with equitable principles.

Petitioners seek to distinguish between interest at an increased rate after maturity and interest on interest by saying that the latter is always a burden and is a quasi penalty disallowed by state law, while interest at the statutory rate after maturity may be either higher or lower than the contract rate. The fact is, however, that in our case the statutory rate is 50% greater than the

contract rate, the difference amounting to approximately $250,000 annually on the First General Mortgage Bonds. A different state of facts would present a different question.

The question now presented to the Court is whether the Bankruptcy Court may allow interest after maturity at the contract rate in effect prior to maturity under the circumstances existing in the Wisconsin Central reorganization in lieu of the substantially higher statutory rate which is allowed as damages for breach of contract under the rule of *O'Brien v. Young,* 95 N. Y. 428, relied on by petitioners; not whether it might properly allow or disallow the contract rate after maturity in event of a lower statutory rate. That question may be answered if and when it arises.

The claim now presented to this Court involves a burden or penalty as severe, if not more severe, than interest on interest. Both the trial court and the Court of Appeals found that continuance of the 4% rate was appropriate under existing economic conditions and that allowance of the higher statutory rate under the circumstances of this case would be inequitable and unjust to other creditors (R. p. 164). Furthermore, while it is perhaps true that interest on interest is not allowed by the law of New York, nevertheless this Court decided the *Vanston* case on the assumption that under applicable state law the covenant to pay interest on interest was valid.

If this Court had intended to limit its decision in the *Vanston* case to the disapproval of claims for interest on interest, it had only to affirm the decision of the Court of Appeals for the Sixth Circuit which had disallowed the claim on the narrow ground that contracts for in-

terest on interest were unenforceable according to the law of New York. But this Court expressly refused to accept that narrow ground as a reason for disallowing the claim and proceeded to hold that the claim should be disallowed on the general rule established in its previous decisions against allowing claims for interest accruing during bankruptcy or other reorganization proceedings except to the extent that such claims can be sustained by *equitable,* as distinguished from *legal,* considerations.

The reasoning of this Court in the *Vanston* case not only supports but inevitably led to the decision below. In an appendix to this brief, we quote in the left-hand column the concluding sentences of the opinion of this Court in the *Vanston* case and paraphrase this language in the right-hand column to show how remarkably close a parallel exists between the two cases.

Petitioners also assert that the decision below is in conflict with the decision of this Court in *Louisville Bank v. Radford,* 295 U. S. 555. That case held that the provision of the Frazer-Lempke Act which required the mortgagee to surrender his mortgage lien without full compensation was repugnant to the Fifth Amendment. Petitioners argue by analogy that the decision by the Court below requires them to surrender their mortgage lien without full compensation and thereby accomplishes an unconstitutional result. The decision of this Court in *Vanston Bondholders Committee v. Green,* 329 U. S. 156, again is a complete answer since the Court below was correct in its premise that the statutory interest at an increased rate after maturity claimed by petitioners is subject to the same powers of the Bankruptcy Court as interest on interest. The mortgage involved in the *Vanston* case contained an express covenant to pay interest on

interest which this Court assumed to be valid under state law and to be a fully secured claim. While the bankruptcy power is subject to the limitations of the Fifth Amendment, it is well established that a bankruptcy court in allowing or disallowing claims can act in accordance with equitable principles and is not bound by purely legal rights. *Heiser v. Woodruff*, 327 U. S. 726; *American Surety Co. v. Sampsell*, 327 U. S. 269; *Pepper v. Litton*, 308 U. S. 295; *Vanston Bondholders Committee v. Green*, 329 U. S. 156.

Petitioners also rely on *American Iron Company v. Seaboard Air Line Railway*, 233 U. S. 261, as establishing the rule that receivership or bankruptcy does not stop the running of interest. The decision of the Court below recognized that rule and is not in conflict therewith. It recognized that interest continued to run on the First General Mortgage Bonds after bankruptcy of the mortgagee and after maturity of the bonds, but held that it was within the equitable power of the Bankruptcy Court to allow such interest after maturity only at the former contract rate of 4% and not at the increased statutory rate of 6%.

The opinion of the Court below does not tell us whether, as petitioners claim, the Court below regarded the *Vanston* case as laying down new rules. We are certain, however, that the Court below did not misinterpret the scope of the decision in the *Vanston* case. The decision below is not in conflict with decisions of this Court. Indeed, no other result could logically or equitably have been reached in view of the decision in the *Vanston* case.

Nor do we agree with petitioners that the federal question decided by the Court below is one frequently arising in corporate reorganizations and should be expressly

settled by this Court. Aside from the two Wisconsin Central Railway Company cases growing out of the present reorganization, petitioners cite no case involving the right to statutory interest after maturity in a bankruptcy, receivership, reorganization or other liquidation proceeding except *Thompson v. Getz* discussed above. We know of only one other such case, viz., *In re Espade Realty Corp.*, 66 Fed. Supp. 683, decided by the United States District Court for the Eastern District of New York before the decision of this Court in the *Vanston* case. We have no reason to believe that the question will be more actively litigated in the future. If and when the question does again arise, we believe that the Bankruptcy Court will find no more difficulty in construing and applying the decision of this Court in the *Vanston* case than did the trial court and the Court of Appeals for the Eighth Circuit. Furthermore, as pointed out above under the discussion of the facts of this case, it appears that a reversal of the Court below on the question presented to this Court would not even change the ultimate result in the present case, since the Court of Appeals was "definitely inclined to the conclusion" that the First General Mortgage properly construed provided for the continuance of the 4% rate after maturity.

III.

The Second Question Posed by the Petition Raises No Issue Not Covered in Connection With the First Question.

The second question posed by the petition for certiorari is, in fact, only a restatement of the first. We know of no case considering the question whether interest under the circumstances here involved should be allowed as an expense of administration. A claim to interest has never been considered, to our knowledge, in any case or in any proceeding before the Interstate Commerce Commission or the Securities and Exchange Commission as an administrative claim entitled to priority over other secured claims. Neither the proof of claim, as filed or as amended (R. pp. 28-36), nor the petitions which led up to this case (R. pp. 38-41, 45-46, 50-53), assert any claim as an expense of administration.

In any event, the question is impliedly answered by the decision of this Court in *Vanston Bondholders Committee v. Green,* 329 U. S. 156. Since enjoining the payment of interest coupons at maturity under the circumstances of the *Vanston* case did not give rise to an administrative claim, there is no reason to believe that enjoining the payment of principal at maturity under the same circumstances would give rise to an administrative claim. Furthermore, as stated above, the question is not one frequently arising or of practical public importance. The cases cited by petitioners with respect to their second question demonstrate neither the doubtfulness nor the importance of this question.

Respondents above named respectfully submit that the petition for a writ of certiorari should be denied.

Dated: February 11, 1952.

Respectfully submitted,

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APPENDIX

We quote in the left-hand column below the concluding sentences of the opinion in *Vanston Bondholders Committee v. Green,* 329 U. S. 156 at 165-167 and paraphrase this language in the right-hand column to show how remarkably close a parallel exists between the facts in the *Vanston* case and the facts in the present case and how the reasoning in the *Vanston* case is decisive in the present case.

"Prior to the beginning of the equity receivership, Inland would have never owed interest on interest unless and until it had breached its obligation to pay simple interest promptly—on the date it was due. Before the receivership began, a failure by Inland to pay coupons on the date they were due might have breached an existing obligation. This breach would have imposed upon Inland, under the terms of the covenant, a duty to pay interest on the interest it had failed to pay. But when the equity receivership intervened, these interrelated obligations were drastically changed. The obligation to make prompt payment of simple interest coupons was suspended. In fact, both Inland and the receiver were ordered by the court not to pay the coupons on the dates they were, on their face, supposed to have been paid. The contingency which might have created a present obligation to pay in-

Prior to the beginning of the equity receivership, the Wisconsin Central would have never owed statutory interest at the rate of 6% per annum unless and until it had breached its obligation to pay the principal of its bonds promptly — on the date they were due. Before the receivership began, a failure by Wisconsin Central to pay the bonds on the date they were due would have breached an existing obligation. This breach would have imposed upon Wisconsin Central, under New York law, a duty to pay interest on the principal which it had failed to pay at the stautory rate of 6% per annum. But when the receivership intervened, these interrelated obligations were drastically changed. The obligation to make prompt payment of the bonds was suspended. In fact, both the Wisconsin Central and its receiver (and ultimately its Trustee) were ordered by the court not

terest on interest—i.e., a free decision by the debtor that it would not or could not pay simple interest promptly—was prohibited from occurring by order of the court. That order issued for a good cause, we may assume: to preserve and protect the debtor's estate pending a ratable distribution among all the creditors according to their interests as of the date the receivership began. The extra interest covenant may be deemed added compensation for the creditor or, what is more likely, something like a penalty to induce prompt payment of simple interest. In either event, first mortgage bondholders would have been enriched and subordinate creditors would have suffered a corresponding loss, because of a failure to pay when payment had been prohibited by a court order entered for the joint benefit of debtor, creditors, and the public. Such a result is not consistent with equitable principles. For legal suspension of an obligation to pay is an adequate reason why no added compensation or penalty should be enforced for failure to pay." (329 U. S. 156 at 165-167.)

to pay the bonds on the dates they were, on their face, supposed to have been paid. The contingency which might have created a present obligation to pay statutory interest—i.e., a free decision by the debtor that it would not or could not pay the bonds promptly—was prohibited from occurring by order of the court. That order issued for a good cause, we may assume: to preserve and protect the debtor's estate pending a ratable distribution among all the creditors according to their interests as of the date the reorganization began. The statutory interest obligation may be deemed added compensation for the creditor or, what is more likely, something like a penalty to induce prompt payment of principal. In either event, first mortgage bondholders would have been enriched and subordinate creditors would have suffered a corresponding loss, because of a failure to pay when payment had been prohibited by a court order entered for the joint benefit of debtor, creditors and the public. Such a result is not consistent with equitable principles. For legal suspension of an obligation to pay is an adequate reason why no added compensation or penalty should be enforced for failure to pay.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1951

No. 534

UNITED STATES TRUST COMPANY OF NEW YORK, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY FIRST GENERAL MORTGAGE,

Appellant-Petitioner,

vs.

EDGAR F. ZELLE, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY, ET AL.,

Appellees-Respondents.

JOSEPH R. WARNER, SAMUEL S. HALL, JR., and PHILIP N. CRISTAL, AS A PROTECTIVE COMMITTEE FOR THE HOLDERS OF WISCONSIN CENTRAL RAILWAY COMPANY FIRST GENERAL MORTGAGE FIFTY YEAR FOUR PER CENT GOLD BONDS DUE JULY 1, 1949,

Appellants-Petitioners,

vs.

EDGAR F. ZELLE, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY, ET AL.,

Appellees-Respondents.

THE GASTON GROUP OF HOLDERS OF WISCONSIN CENTRAL RAILWAY COMPANY FIRST GENERAL MORTGAGE BONDS,

Appellants-Petitioners,

vs.

EDGAR F. ZELLE, AS TRUSTEE OF WISCONSIN CENTRAL RAILWAY COMPANY, ET AL.,

Appellees-Respondents.

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INDEX

Page

I. Reply to brief of respondent Zelle and others..... 1
   1. Questions presented 1
   2. The matter involved 3
   3. Other matters 4

II. Reply to brief of respondent Wisconsin Central Railway Company, debtor 4
   1. The argument that *Vanston* and *Fleming* are dispositive of the issues presented 4
   2. The argument that there is in fact no conflict with other decisions 5

TABLE OF AUTHORITIES

Cases

Page

Fleming, Traphagen, 329 U. S. 686 4
In re Chicago R. I. & P. Ry., 155 F. 2d 889 5
In re Wisconsin Central Ry. Co., 63 F. Supp. 151 3
Sexton v. Dreyfus, 219 U. S. 339 5
Thompson v. Getz, 178 F. 2d 325 5
Ticonic Bank v. Sprague, 303 U. S. 406 .....5, 6
United States Trust Co. of New York v. Zelle, 191 F. 2d 822 3
Vanston Committee v. Green, 329 U. S. 156.....3, 4, 5

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Appellees-Respondents.

REPLY BRIEF

I.

REPLY TO BRIEF OF RESPONDENT ZELLE AND OTHERS.

1. Questions Presented.

Respondents Edgar F. Zelle and others, on page 3 of their brief, rephrase the questions presented to limit the question before this Court to that of allowing interest at the state law legal rate in cases where the Court finds that it would

be inequitable to impose such interest as an expense on the estate "to the financial detriment and disadvantage of the other creditors."

So rephrased the question presupposes that if there is allowance of a 6% rate it will necessarily be at the expense of other creditors, and not simply the Debtor and its shareholders.

But allowance at this stage does not necessarily mean payment at this stage, a point emphasized by the petition of the Mortgage Trustee herein (R. 38) which was filed a month before the contract maturity date, July 1, 1949, and asked simply for a declaration that the bondholders were entitled to the allowance of 6% interest after such date. If, after allowance, sound reasons for deferment of immediate payment of all or part of the interest should exist, actual payment could of course be deferred.

On the other hand, absolute disallowance of the claim now, as will result if the judgment of the court below stands, will mean that in bankruptcy, receivership and other like situations, the interest rate applicable under state law may be absolutely disallowed to the ultimate benefit not of other creditors but solely of the bankrupt itself or of its shareholders. That this result is not a fanciful one in this very proceeding is evidenced by the participation here of the Debtor, who is representing the interests of the shareholders who will of course participate only after the allowance of all creditors' claims in full both for principal and interest.

In the light of all this, it is submitted that the questions presented have been improperly phrased by these respondents and further that the judgment below is directly contrary to

the rule enunciated by this Court in the *Vanston* case, wherein this Court stated (329 U. S. 156, 164):

> "But where an estate was ample to pay all creditors and to pay interest even after the petition was filed, equitable considerations were invoked to permit payment of this additional interest to the secured creditor rather than to the debtor. *Coder v. Arts,* 213 U. S. 223, 245; *Sexton v. Dreyfus,* supra. See also *Johnson v. Norris,* 190 F. 459."

2. The Matter Involved.

Respondents Zelle and others, on pages 3 and 4 of their brief in opposition, quote the dictum of the Court of Appeals that it was "inclined to the conclusion" that the First General Mortgage properly construed provided for a continuance of the 4% rate after maturity. The Court of Appeals, however, was careful to point out that "we do not deem it necessary to pass upon the question" (191 F. 2d 822, 824).

Inasmuch as the Court of Appeals did not decide the question, this Court should not treat the case as if it had been decided on that basis, particularly when the dictum of the Court of Appeals was on an issue which the lower court had decided favorably to petitioner after careful consideration of mortgages with which it had been intimately familiar throughout this proceeding for many years. This case involved clauses closely similar to those in another mortgage in the proceeding, the so-called Superior and Duluth Mortgage, which the same District Judge had earlier *In re Wisconsin Central Ry. Co.,* 63 F. Supp. 151, construed in the same manner. As a result of the reasoned opinion of the District Court, petitioners took only brief notice of the

mortgage construction question in their brief in the Court of Appeals and devoted their oral argument there principally to the equity and bankruptcy issues involved. In the circumstances we submit that the unsupported dictum in the opinion below can furnish no sure indication of a similar result in the event of remand and can furnish no cause for not determining here the issue on which the decision below was based.

3. Other Matters.

The rest of the material in the brief of respondents Zelle and others, including the Argument on pages 5 through 12, appears to have been met so squarely by petitioners' brief incorporated in their petition that further answer in this reply would be inappropriate.

II.

REPLY TO BRIEF OF RESPONDENT WISCONSIN CENTRAL RAILWAY COMPANY, DEBTOR.

1. The argument that *Vanston* and *Fleming* are dispositive of the issues presented.

The Debtor, at pages 5 and 6, argues that because in *Fleming vs. Traphagen,* 329 U. S. 686, the bonds involved "were not even affected by a plan of reorganization," the *Fleming* case establishes the correctness of the decision below. But the decision in *Fleming* necessarily followed from that in *Vanston,* since it involved simply interest upon over-

due interest, the same question involved in *Vanston*. The fact that the bonds in the *Fleming* case happened to have been left undisturbed under the plan of reorganization made no difference on the issue, for the subsidiary whose bonds were involved was also a debtor in reorganization in the proceedings and the Court's orders had enjoined the payment of bond interest as it became due (*In re Chicago, R. I. & P. Ry.*, 155 F. 2d 889 at 891), just as had the Court's orders enjoined the payment of the bond interest in the *Vanston* case.

2. The argument that there is in fact no conflict with other decisions.

The Debtor's argument on pages 6 through 9 that cases such as *Thompson v. Getz*, 178 F. 2d 325, and *Ticonic Bank v. Sprague*, 303 U. S. 406, are not in conflict with the decision of the court below here is based on an entire misconception of the basically analogous character of all federal insolvency proceedings, something this Court has made very clear in the *Vanston* case itself. The emphasis on ordinary bankruptcy cases such as *Sexton v. Dreyfus*, 219 U. S. 339, in the Court's opinion on pages 163-165, the recognition throughout the opinion of the application of the same rules in bankruptcy and equity receivership, the express reference to analogous principles being applied to the liquidation of national banks in footnote 7 on page 165, all demonstrate the absence of any pertinent distinctions between the several types of proceedings. The allowance of legal interest in *Thompson v. Getz, supra*, necessarily made less favorable the treatment of junior creditors and stockholders in the ar-

rangement under Chapter 11 there. Likewise the allowance of legal interest in *Ticonic Bank v. Sprague, supra,* reduced the amount available for other creditors in that bank liquidation. The language of the court below here is just as applicable to the situation in *Ticonic Bank v. Sprague, supra,* as to that in the case at bar.

Petitioners respectfully submit that their petition for certiorari, as prayed for, should be granted.

Dated February 21, 1952.

Respectfully submitted,

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